

Message Text

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FM AMEMBASSY BONN
TO SECSTATE WASHDC 0395
DEPARTMENT TREASURY

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SUBJECT: ECONOMICS MINISTER LAMBSDORFF PROPOSES
DM 15-20 BILLION STIMULUS FOR ECONOMY

IN A JULY 5 LETTER TO CHANCELLOR SCHMIDT WHICH WAS
PUBLISHED IN THE JULY 17 EDITION OF HANDELSBLATT,
ECONOMICS MINISTER LAMBSDORFF RECOMMENDS A
DM 15-20 BILLION FISCAL STIMULUS FOR THE ECONOMY IN
1979. THE OVERWHELMING PART, HE SAYS, SHOULD BE IN
THE FORM OF REDUCTIONS IN DIRECT TAXES WHICH WOULD
STIMULATE PRIVATE INVESTMENT AND GIVE A LASTING
IMPULSE TO PRIVATE CONSUMPTION. WITHOUT ADDITIONAL
STIMULUS, LAMBSDORFF FORESEES AN ECONOMIC SLOWDOWN
IN 1979. ACCORDING TO MEDIA REPORTS, CHANCELLOR
SCHMIDT PRIVATELY WAS FURIOUS ABOUT LEAKING OF THE
LAMBSDORFF PROPOSAL. BELOW IS AN INFORMAL TRANSLATION
OF THE LETTER.

DEAR MR. CHANCELLOR
BEFORE THE MEETING OF THE EUROPEAN COUNCIL IN BREMEN
AND THE CONFERENCE OF STATE AND GOVERNMENT HEADS IN
BONN, I WOULD LIKE TO GIVE YOU MY PERSONAL ESTIMATE
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OF THE ECONOMIC SITUATION AND PROSPECTS FOR THE
FEDERAL REPUBLIC.

AS IS TO BE INFERRED FROM THE PROGNOSES OF OTHER
INSTITUTIONS, IT CAN NO LONGER BE TAKEN FOR GRANTED
THAT A GNP GROWTH RATE OF 3 1/2 PERCENT WILL BE REACHED
THIS YEAR, THE GOAL SET BY THE YEARLY ECONOMIC REPORT.

FOLLOWING THE STAGNATION OF PRODUCTION IN THE FIRST QUARTER, TODAY'S OUTLOOK IS FOR A PROBABLE INCREASE OF THE REAL GNP ON THE ORDER OF 2 TO 3 PERCENT. THIS FORESEES A YEARLY RATE OF INCREASE OF BETWEEN 3 AND 4 PERCENT BEGINNING WITH THE SECOND QUARTER AND RUNNING THROUGH THE END OF THE YEAR.

ACCORDING TO THE PRELIMINARY CALCULATIONS OF THE STATISTICAL OFFICE, PRODUCTION AND NEW ORDERS (SEASONALLY ADJUSTED) FOR THE MONTHS OF APRIL AND MAY REMAINED AT THE VERY LOW LEVELS OF THE FIRST MONTHS OF THE YEAR. ACCORDINGLY, PRODUCTION IN THESE TWO MONTHS WAS ONLY ABOUT 1 PERCENT HIGHER THAN A YEAR AGO AND ORDERS (VALUE) ONLY AROUND 4 PERCENT HIGHER. WHILE PRIVATE CONSUMPTION HAS DEVELOPED IN THE COURSE OF THE YEAR MORE FAVORABLY THAN WAS IMPLIED IN THE YEARLY ECONOMIC REPORT AND CONSTRUCTION HAS, UNDER THE INFLUENCE OF THE MEASURES TAKEN BY THE GOVERNMENT AND THE DECLINE IN INTEREST RATES, GIVEN A CYCLICAL BOOST TO THE ECONOMY, THE DEVELOPMENT OF PRIVATE INVESTMENT AND OUR FOREIGN TRADE CAUSE ME CONCERN. THE ONLY WEAK INCREASE IN REAL EXPORTS HAS BEEN MORE THAN OFFSET BY A STRONG INCREASE IN IMPORTS SO THAT THE FOREIGN SECTOR HAS HAD A STRONGLY CONTRACTIONARY IMPACT ON ECONOMIC GROWTH.

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CONSIDERABLE UNCERTAINTIES INDEED UNDERLIE ANY PREDICTION ABOUT POSSIBLE ECONOMIC GROWTH FOR 1979. STILL IT IS TO BE NOTED THAT IN ORDER TO OBTAIN THE GROWTH RATE OF 4 1/2 PERCENT DECIDED UPON BY THE CABINET, CONSIDERABLE STIMULATION IS NECESSARY. AS OPPOSED TO THE PROBABLY MORE FAVORABLE DEVELOPMENT OF THE ECONOMY IN THE COURSE OF THIS YEAR, A SLOWDOWN COULD OCCUR IN 1979.

THIS WOULD ESPECIALLY HOLD IF PRIVATE INVESTMENT DOES NOT PICK UP; HOWEVER, AT THIS TIME THERE IS NO INDICATION OF SUCH A REVIVAL. THE INCREASE IN PRIVATE CONSUMPTION EXPENDITURES COULD ALSO WEAKEN; GIVEN THE NECESSITY FOR RESTRAINT IN WAGE NEGOTIATIONS, THE EXPANSIONARY IMPACT OF TAX REDUCTIONS WHICH TOOK EFFECT AT THE BEGINNING OF 1978 WILL WEAKEN AND THE PROGRESSIVE EFFECT OF WAGE TAXES WILL BECOME EVEN STRONGER.

DISBURSEMENTS OF THE SOCIAL SECURITY SYSTEM WILL, DESPITE THE INCREASE IN BENEFITS AT THE BEGINNING OF THE YEAR, SLACKEN IN COMPARISON WITH THIS YEAR. ALSO THE DECLINE OF THE SAVINGS RATIO WILL NOT BE

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FAVORED TO THE SAME DEGREE THROUGH SPECIAL FACTORS
SUCH AS THE UNBLOCKING OF PREVIOUSLY FROZEN SAVINGS
DEPOSITS; MOREOVER, A LOWER RATE OF GROWTH OF PUBLIC
SECTOR EXPENDITURES (ACCORDING TO THE FINANCIAL PLAN
6 PERCENT INSTEAD OF AN EXPECTED 10 PLUS PERCENT IN
1978) HAS TO BE TAKEN INTO CONSIDERATION.

IT IS SCARCELY PROBABLE THAT THESE COMBINED WEAKER
IMPULSES WILL BE OFFSET BY A NOTICEABLY MORE FAVORABLE
DEVELOPMENT OF FOREIGN TRADE. THEREFORE THE PROSPECTS
FOR A BETTER ECONOMIC PERFORMANCE IN 1980 ARE UN-
FAVORABLE.

ALTOGETHER THIS WILL CAUSE SERIOUS ECONOMIC AND
FINANCIAL PROBLEMS. UNEMPLOYMENT ESPECIALLY WOULD
BE INCREASED BY SUCH A WEAK GROWTH RATE. THE
PUBLIC SECTOR DEFICIT WOULD INCREASE BECAUSE OF LOWER
TAX PAYMENTS AND THE NECESSARY CONSOLIDATION OF THE
SOCIAL SECURITY SYSTEM WOULD AGAIN BE JEOPARDIZED.

I CONSIDER IT NECESSARY TO TAKE AN EARLY DECISION TO
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STRENGTHEN THE TREND IN GROWTH SO THAT A GNP GROWTH RATE OF 3 TO 4 PERCENT CAN BE ATTAINED IN 1979. THIS GROWTH RATE IS NECESSARY IF A CONSIDERABLE WORSENING OF THE EMPLOYMENT SITUATION IS TO BE AVOIDED.

IN MY VIEW AN ADDITIONAL FINANCIAL IMPULSE OF 10 TO 15 BILLION DM WILL BE NECESSARY AT THE BEGINNING OF 1979. THE OVERWHELMING PART SHOULD BE INCORPORATED INTO MEASURES FOR LOWERING DIRECT TAXES SO THAT CONDITIONS FOR INVESTMENT BY ENTERPRISE ARE IMPROVED AND, ON THE DEMAND SIDE, NEW AND LASTING IMPULSES CAN BE TRANSMITTED ESPECIALLY TO THE PRIVATE CONSUMPTION SECTOR. MOREOVER, THE STATES AND COMMUNITIES ARE DIRECTLY PARTICIPATING IN THE EXPANSIONARY MEASURES FROM TAX CUTS WHICH IS NOT NECESSARILY THE CASE WITH NEW EXPENDITURE PROGRAMS.

I DO NOT DENY THAT HIGHER PUBLIC SECTOR DEFICITS CAN CAUSE DIFFICULT FINANCIAL PROBLEMS UNDER CERTAIN CIRCUMSTANCES. A LOWER RATE OF GROWTH WILL, HOWEVER, CAUSE AN OTHERWISE HIGHER DEFICIT. TO THE EXTENT THAT TAX REDUCTIONS MEASURES CONTRIBUTE TO AN IMPROVEMENT IN THE ECONOMIC SITUATION, A DECREASE IN THE ENSUING DEFICITS WILL BE MADE EASIER. SHOULD THIS NOT SUFFICE TO MEET THE ADDITIONAL FINANCING REQUIREMENTS, THEN LIMITATIONS ON EXPENDITURES FOR THE NEXT YEAR, AS WELL AS AN INCREASE IN INDIRECT TAXES, SHOULD BE CONSIDERED.

IN THE MEANTIME IT IS IMPORTANT THAT, WITH THE HELP OF A VERY FLEXIBLE DEBT MANAGEMENT POLICY, AN EFFORT IS MADE TO COVER THE TEMPORARY RISE IN PUBLIC SECTOR FINANCIAL NEEDS WITHOUT A SUBSTANTIAL INCREASE IN UNCLASSIFIED

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INTEREST RATES.

SUCH A POLICY DOES NOT MEAN THAT WE SHOULD GIVE UP THE GOAL OF CONSOLIDATION THAT I, AS BEFORE, HOLD ESSENTIAL. IT IS OF CHIEF IMPORTANCE, HOWEVER, THAT WE REACH SELF-SUSTAINING GROWTH AND THAT THE DANGER OF ECONOMIC CONTRACTION BE EXORCISED.

YOU CERTAINLY REMEMBER THE BUNDESBANK'S POINT OF VIEW AT THE CABINET MEETING ON JUNE 7. THEREFORE, I THINK IT NECESSARY THAT WITHIN SO SHORT A TIME AS NECESSARY TALKS ABOUT THE WHOLE ECONOMIC SITUATION SHOULD BE

UNDERTAKEN WITH THE DIRECTORATE OF THE BUNDESBANK.
SINCERELY, LAMBSDORFF.
STOESSEL

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